

ROBERT L. BROWN III

ATTORNEY AT LAW

1005 SOUTH MAIN STREET
CORBIN, KENTUCKY 40701

(606) 528-3073
FAX (606) 528-3289

November 12, 2004

VIA HAND DELIVERY

Public Service Commission
Ms. Beth O'Donnell
Executive Director
211 Sower Blvd.
P.O. Box 615
Frankfort, KY 40602

RECEIVED

NOV 12 2004

PUBLIC SERVICE
COMMISSION

Case 2004-00444

**RE: CITIPOWER, LLC - APPLICATION OF CITIPOWER, LLC FOR
APPROVAL OF NOTE RENEWAL
CASE NO. ~~2004-00123~~**

CITIPOWER, LLC - APPLICATION OF REORGANIZATION

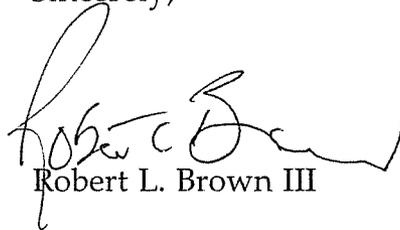
Dear Ms. O'Donnell:

Enclosed please find an original and six copies of the Response to Commission Staff's Third Data Request to Citipower, LLC as it relates to the above-mentioned matter to be properly filed.

Also enclosed is an original and six copies of an Application of Reorganization of Citipower, LLC, to be properly filed.

Thank you for your assistance in this matter, and should you have any questions please do not hesitate to contact me.

Sincerely,



Robert L. Brown III

RLB/ca

Enclosures

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NOV 12 2004

PUBLIC SERVICE
COMMISSION

Case 2004-00444

**APPLICATION OF REORGANIZATION
CITIPOWER, LLC**

BEFORE

**COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION**

**211 Sower Blvd.
P. O. Box 615
Frankfort, Kentucky 40602**

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APPLICATION FOR REORGANIZATION OF CITIPOWER, LLC

THIS APPLICATION FOR REORGANIZATION is respectfully submitted as of the 12 day of November, 2004 by **CITIPOWER, LLC**, a Kentucky limited liability company ("Citipower").

Submitted To:

Ms. Beth O'Donnell
Executive Director
Public Service Commission
211 Sower Blvd.
P. O. Box 615
Frankfort, KY 40602

Hon. Gregory D. Stumbo
Attorney General
David Edward Spenard
Assistant Attorney General
1024 Capital Center Drive
Suite 200
Frankfort, KY 40601-8204

1. **HISTORY.** Citipower purchased the natural gas utility assets of McCreary Natural Gas System, Inc., a farm tap system, on September 26, 1996. Citipower came under the Kentucky Public Service Commission's jurisdiction in November 1997, a year after the purchase.

In addition to its regulated utility assets in Kentucky, Citipower currently has two subsidiaries that engage solely in non-regulated activities. Citigas, L.L.C. ("Citigas"), a Delaware limited liability company, is a 100% Citipower-owned affiliate that owns a gas gathering system in Humboldt County, California. The other subsidiary is LBU, L.L.C. ("LBU"), a Tennessee limited liability company, in which Citipower owns an 87.52% interest. LBU owns 49% of the Lick Branch Unit, a FERC regulated gas storage and oil production field located in Scott County, Tennessee. Citipower also owns another non-regulated asset, being an 11.5 mile, 4" steel pipeline and an associated compressor site, that are used for the transmission of gas to the Citizen Gas Utility District's high-pressure pipeline in Tennessee.

On December 11, 1997 Citipower borrowed from Bank of McCreary County \$250,000.00 in the form of a revolving line of credit. Citipower borrowed from the line on occasion and repaid the line to a zero balance several times. The last time the line was at zero balance was January 7, 1999. (See Exhibit "A"). The use of the proceeds from the various borrowings were for working capital of Citipower. The financial statements of Citipower reflected this borrowing base from time to time.

On December 16, 1998 Citipower borrowed from Bank of McCreary County \$500,000.00 in the form of a term note. The use of the proceeds from the \$500,000.00 loan was for the building of an unregulated pipeline in Tennessee.

On January 6, 1999 Citipower borrowed from Bank of McCreary County \$250,000.00 in the form of a term note. The use of the proceeds from the \$250,000.00 loan was for the purchase of an unregulated investment (LBU) in Tennessee.

On November 19, 2002 the three debts mentioned above were refinanced into a single note in the amount of \$1,000,000.00 that has a current balance of \$993,173.81 and which expires on November 19, 2004.

Subsequent to various interaction between the Public Service Commission and Citipower, the Public Service Commission noted in a report dated February 27, 2004 that Citipower renewed a one-year term loan in December 2003 which appears to be a violation of KRS 278.300, and that Citipower assumed a four year note to Oneida Gas as an investment in LBU, LLC which appears to be a violation of KRS 278.300. Citipower applied to the Public Service Commission for approval of the term loan renewal on March 19, 2004. The Public Service Commission opened Case No. 2004-00123 on March 26, 2004 to consider Citipower's application. Currently, the Public Service Commission and Citipower are transferring information regarding data requests regarding Case No. 2004-00123.

As a result of the above-referenced facts, together with the planning for the optimum consumer, shareholder, and management benefit, Citipower proposes the Reorganization of its structure as set forth in Paragraph 2 hereinbelow.

2. **REORGANIZATION PROPOSAL.** In Step One, Citipower, LLC will contribute one of its non-regulated assets (a pipeline starting at the Tennessee border and wholly located in Tennessee) to Citigas.

In Step Two, Citipower will form a new entity, Citi Energy, LLC, ("Citi Energy"), which will own Citipower, Citigas and LBU. The new holding company, Citi Energy, will be formed as a Delaware limited liability company that will have an operating agreement identical to that of Citipower. Citi Energy will have the same shareholders and the same classes of ownership as Citipower. Citipower owners will exchange their ownership for ownership in Citi Energy. The result of this share exchange is that the current owners will own the same assets and businesses as now, but through the Citi Energy holding company. When the restructuring is completed, Citi Energy will own three subsidiaries; Citipower LLC (the regulated utility), LBU (the underground gas storage facility) and Citigas LLC (owner of the California pipeline and Tennessee pipeline).

In Step Three, Citi Energy will borrow \$1,000,000.00 from RBC Centura and pay off \$750,000.00 of the existing Bank of McCreary County note. Citipower will remain liable for the remaining \$250,000.00 of the existing Bank of McCreary County note. Citipower is owed \$250,000.00 by Forexco, Inc., which debt will be paid by Forexco, Inc., on or before December 31, 2004.

The collateral for the existing Bank of McCreary County note will remain to be the assets of the regulated utility, Citipower. The collateral for the RBC Centura loan will be assignments of all ownership interests in Citi Energy's subsidiaries (a stock pledge) that includes 100% of Citipower, LLC; 100% of Citigas, LLC; and 87.52% of Lick Branch Unit, LLC and its subsequent 49% interest in Lick Branch Unit Joint Venture. A First Uniform Commercial Code lien on all assets of Citigas, will be granted to RBC Centura. RBC Centura will also obtain 100% unconditional guaranties from Daniel R. Forsberg (Individual), Citigas and LBU. RBC Centura will not take a collateral interest in the assets of Citipower. A diagram outlining the proposed reorganization, together with pro forma financial statements are attached as Exhibit "B" and "C" respectively.

3. **STATUTORY REFERENCES.**

- a. KRS § 278.020 (4) and (5) govern the transfer of ownership and control of a utility. Citipower hereby seeks Commission approval and states that approval is justified in that:
 - i. While the ownership of Citipower will technically change from the individual shareholders to the new holding company (Citi Energy), the same individual shareholders will own exactly the same interest in the holding company and therefore there is no change in control as defined by statute;
 - ii. The requested reorganization will not change the regulated assets or debts of Citipower;
 - iii. The requested reorganization will not change the current management of Citipower.
 - iv. The reorganization facilitates the restructure of non-regulated indebtedness that is addressed in PSC Case No. 2004-00123.
- b. KRS § 278.010 (3) will still include Citipower as a "Utility" after the proposed reorganization and afford the same regulatory structure and protection as immediately prior to the proposed reorganization.
- c. KRS § 278.300 as it relates to Citipower after the proposed reorganization will not be influenced by the growth or operations of separate subsidiary entities such as Citigas or LBU as they have in the past. All regulated debt after the proposed reorganization shall be obligations of Citipower only.
- d. KRS § 278.2201 through § 278.2219 will be facilitated by the proposed reorganization in that the regulated and non-regulated assets will be separate and distinct and any common expenses or management monitored through approved accounting procedures.

4. **SUMMARY.**

As Citipower continues its expansion into unregulated activities, and in order to cease and further prevent the complications that exist when a regulated utility owns non-regulated assets, Citipower seeks Commission approval to act as follows:

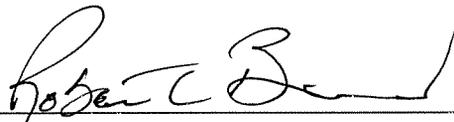
- a. Create a holding company (Citi Energy) that will not be recognized as a utility as defined in KRS 278.010 (3).
- b. Reorganize by creating Citi Energy that will issue ownership units to Citipower's current owners in exchange for their ownership units in Citipower. Citipower would then be a 100% owned subsidiary of Citi Energy.
- c. In consideration of the true cost and debt assumption, spin-off the ownership of Citigas and LBU from Citipower to Citi Energy.
- d. Citipower will then own only the regulated utility assets.

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

**APPLICATION OF CITIPOWER, LLC FOR
APPROVAL OF REORGANIZATION**

CASE NO. 2004-_____

By: 
Law Offices of:
Robert L. Brown III
1005 South Main Street
Corbin, Kentucky 40701
Telephone: (606) 528-3073
Attorney for Citipower, LLC

CERTIFICATE

I hereby certify that the above and foregoing was on the 12 day of November, 2004, served by mailing the original and six true and exact copies of same, all postage prepaid, addressed for delivery to:

Ms. Beth O'Donnell
Executive Director
Public Service Commission
211 Sower Blvd.
P. O. Box 615
Frankfort, KY 40602

Hon. Gregory D. Stumbo
Attorney General
David Edward Spenard
Assistant Attorney General
1024 Capital Center Drive
Suite 200
Frankfort, KY 40601-8204

By: 
Robert L. Brown III

EXHIBIT A

Bank of McCreary County Line of Credit History

RECEIVED

OCT 29 2004



AB-101 REL # 4.01.00 (BRANCH 1, OPER BDB) WEDNESDAY OCT 27 2004

INQ - TRANS HISTORY

CITIPOWER LLC

CUST-NO 02007980 DEPT-NO 0 LOAN-NO EFF DATE? Y OR N (N)

LOAN-NO	P	CL	RATE	T/C	PR	DATE	PRIN AMT	TNT-AMT	LOAN BALANCE
1 00009440	0	09	8.750	801	01	010902	.00	5,590.28-	250,000.00
1 00009440	0	09	8.750	801	01	010902	.00	.00	250,000.00
1 00009440	0	09	8.750	801	01	010902	250,000.00-	.00	.00
1 00009440	0	09	8.750	801	01	010902	.00	.00	250,000.00
1 00009440	0	09	8.750	801	01	010902	250,000.00-	12,000.00-	.00
PAYOFF DESC:									
2 00104101	0	09	9.500	800	01	111297	.00	.00	.00
2 00104101	0	09	9.500	805	01	111297	125,000.00	.00	125,000.00
2 00104101	0	09	9.500	805	01	111797	20,000.00	.00	145,000.00
2 00104101	0	09	9.500	805	01	121797	50,000.00	.00	195,000.00
2 00104101	0	09	9.500	805	01	121797	5,000.00	.00	200,000.00
2 00104101	0	09	9.500	801	01	122297	50,000.00-	.00	150,000.00
2 00104101	0	09	9.500	801	01	122297	30,000.00-	.00	120,000.00

Continue, End #



1

AB-101 REL # 4.01.00

(BRANCH 1, OPER BDB)

WEDNESDAY OCT 27 2004

INQ - TRANS HISTORY

CITIPOWER LLC

CUST-NO 02007980

DEPT-NO 0

LOAN-NO

EFF DATE?

Y OR N (N)

LOAN-NO	P	CL	RATE	T/C	BR	A	DATE	PRIN-AMT	INT-AMT	LOAN BALANCE
00104101	0	09	9.500	805	01	01	010298	50,000.00	.00	170,000.00
00104101	0	09	9.500	801	01	01	012798	100,000.00-	.00	70,000.00
00104101	0	09	9.500	801	01	01	013098	70,000.00-	.00	.00
00104101	0	09	9.500	801	01	01	021198	.00	3,133.70-	.00
00104101	0	09	9.500	805	01	01	021798	65,000.00	.00	65,000.00
00104101	0	09	9.500	805	01	01	042298	65,000.00	.00	130,000.00
00104101	0	09	9.500	801	01	01	051298	.00	1,725.62-	130,000.00
00104101	0	09	9.500	801	01	01	051298	130,000.00-	.00	.00
00104101	0	09	9.500	805	01	01	080798	90,000.00	.00	90,000.00
00104101	0	09	9.500	801	01	01	082098	19,906.30-	.00	70,093.70
00104101	0	09	9.500	801	01	01	082098	.00	93.70-	70,093.70
00104101	0	09	9.500	801	01	01	082898	50,000.00-	.00	20,093.70
00104101	0	09	9.500	805	01	01	090198	50,000.00	.00	70,093.70

Continue, End

2

AB-101 REL # 4.01.00

(BRANCH 1, OPER BDB)

WEDNESDAY OCT 27 2004

INQ - TRANS HISTORY

CITIPOWER LLC

CUST-NO 02007980 DEPT-NO 0 LOAN-NO EFF DATE? Y OR N (N)

LOAN-NO	P	CL	RATE	T/C	BR	A	DATE	PRIN-AMT	INT-AMT	LOAN BALANCE
2 00104101	0	09	9.500	805	01		090998	30,000.00	.00	100,093.70
2 00104101	0	09	9.500	805	01		102998	20,000.00	.00	120,093.70
2 00104101	0	09	9.500	801	01		110298	20,000.00-	.00	100,093.70
2 00104101	0	09	9.500	801	01		110998	100,093.70-	1,977.31-	.00
2 00104101	0	09	9.000	825	01		112098	RATE CHANGE		.00
2 00104101	0	09	9.000	805	01		121098	30,000.00	.00	30,000.00
2 00104101	0	09	9.000	805	01		121598	68,000.00	.00	98,000.00
2 00104101	0	09	9.000	815	01		121698	68,000.00-	.00	30,000.00
2 00104101	0	09	9.000	801	01		123098	30,000.00-	.00	.00
2 00104101	0	09	8.750	825	01		010199	RATE CHANGE		.00
2 00104101	0	09	8.750	805	01		010799	150,000.00	.00	150,000.00
2 00104101	0	09	8.750	805	01		011399	6,500.00	.00	156,500.00
2 00104101	0	09	8.750	805	01		012899	10,000.00	.00	166,500.00

Continue, End

3

INQ - TRANS HISTORY

CITIPOWER LLC
 CUST-NO 02007980 DEPT-NO 0 LOAN-NO EFF DATE? Y OR N (N)

D	LOAN-NO	P	CL	RATE	T/C	BR	A	DATE	PRIN-AMT	INT-AMT	LOAN BALANCE
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2	00104101	0	09	8.750	805	01	021199		15,000.00	.00	175,000.00
2	00104101	0	09	8.750	801	01	022699		50,000.00-	.00	125,000.00
2	00104101	0	09	8.750	801	01	022699		.00	288.99-	125,000.00
2	00104101	0	09	8.750	805	01	030499		15,000.00	.00	140,000.00
2	00104101	0	09	8.750	805	01	031199		8,000.00	.00	148,000.00
2	00104101	0	09	8.750	801	01	032599		100,000.00-	.00	48,000.00
2	00104101	0	09	8.750	805	01	040899		5,000.00	.00	53,000.00
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2	00104101	0	09	8.750	805	01	051299		8,650.00	.00	97,650.00

Continue, End *

4

INQ - TRANS HISTORY

CITIPOWER LLC

CUST-NO 02007980 DEPT-NO 0 LOAN-NO EFF DATE? Y OR N (N)

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2 00104101	0	09	8.750	805	01	051799		13,000.00	.00	140,650.00
2 00104101	0	09	8.750	805	01	052099		3,000.00	.00	143,650.00
2 00104101	0	09	8.750	805	01	052799		31,600.00	.00	175,250.00
2 00104101	0	09	8.750	801	01	060399		30,000.00-	.00	145,250.00
2 00104101	0	09	8.750	805	01	060799		2,500.00	.00	147,750.00
2 00104101	0	09	8.750	805	01	061099		19,000.00	.00	166,750.00
2 00104101	0	09	8.750	805	01	061799		12,000.00	.00	178,750.00
2 00104101	0	09	8.750	805	01	062599		15,000.00	.00	193,750.00
2 00104101	0	09	8.750	805	01	070199		14,000.00	.00	207,750.00
2 00104101	0	09	8.750	805	01	070899		14,000.00	.00	221,750.00
2 00104101	0	09	8.750	805	01	071999		12,000.00	.00	233,750.00
2 00104101	0	09	8.750	805	01	072999		13,000.00	.00	246,750.00

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INQ - TRANS HISTORY

CITIPOWER LLC

CUST-NO 02007980

DEPT-NO 0

LOAN-NO

EFF DATE?

Y OR N (N)

LOAN-NO	P	CL	RATE	T/C	BR	A	DATE	PRIN-AMT	INT-AMT	LOAN BALANCE
2 00104101	0	09	8.750	801	01	080599		.00	4,223.80-	246,750.00
2 00104101	0	09	9.250	825	01	100199	RATE CHANGE			246,750.00
2 00104101	0	09	9.250	830	01	111999	LT CHRG	.00	10.00	246,750.00
2 00104101	0	09	9.250	801	01	112299		.00	5,580.60-	246,750.00
2 00104101	0	09	9.250	823	01	112399		.00	10.00-	246,750.00
2 00104101	0	09	9.500	825	01	010100	RATE CHANGE			246,750.00
2 00104101	0	09	9.500	801	01	021100		.00	5,822.29-	246,750.00
2 00104101	0	09	10.000	825	01	033100	RATE CHANGE			246,750.00
2 00104101	0	09	10.000	801	01	050900		.00	5,915.23-	246,750.00
2 00104101	0	09	10.000	801	01	061200		100,000.00-	.00	146,750.00
2 00104101	0	09	10.500	825	01	063000	RATE CHANGE			146,750.00
2 00104101	0	09	10.500	801	01	080900		.00	4,658.04-	146,750.00
2 00104101	0	09	10.500	805	01	102500		100,000.00	.00	246,750.00

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AB-101 REL # 4.01.00

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WEDNESDAY OCT 27 2004

INQ - TRANS HISTORY

CITIPOWER LLC

CUST-NO 02007980 DEPT-NO 0 LOAN-NO EFF DATE? Y OR N (N)

D	LOAN-NO	P	CL	RATE	T/C	BR	A	DATE	PRIN-AMT	INT-AMT	LOAN BALANCE
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2	00104101	0	09	LT CHRG	830	01		112100	.00	10.00	246,750.00
2	00104101	0	09	10.500	802	01		120600	246,750.00-	.00	.00
2	00104101	0	09	10.500	810	01		120600	246,750.00	.00	246,750.00
2	00104101	0	09	10.500	801	01		021201	.00	6,530.42-	246,750.00
2	00104101	0	09	9.000	825	01		033001	RATE CHANGE		246,750.00
2	00104101	0	09	9.000	823	01		051401	.00	10.00-	246,750.00
2	00104101	0	09	9.000	801	01		051601	.00	5,911.86-	246,750.00
2	00104101	0	09	8.000	825	01		062901	RATE CHANGE		246,750.00
2	00104101	0	09	8.000	801	01		081701	.00	5,320.34-	246,750.00
2	00104101	0	09	7.000	825	01		100101	RATE CHANGE		246,750.00
2	00104101	0	09	7.000	801	01		111601	.00	4,698.39-	246,750.00
2	00104101	0	09	LT CHRG	830	01		112101	.00	10.00	246,750.00

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AB-101 REL # 4.01.00

(BRANCH 1, OPER BDB)

WEDNESDAY OCT 27 2004

INQ - TRANS HISTORY

CITIPOWER LLC

CUST-NO 02007980 DEPT-NO 0 LOAN-NO EFF DATE? Y OR N (N)

D	LOAN-NO	P	CL	RATE	T/C	BR	A	DATE	PRIN-AMT	INT-AMT	LOAN BALANCE
2	00104101	0	09	7.000	802	01		112301	246,750.00-	.00	.00
2	00104101	0	09	6.500	810	01		112301	246,750.00	.00	246,750.00
2	00104101	0	09	5.750	825	01		010102	RATE CHANGE		246,750.00
2	00104101	0	09	5.750	801	01		021802	.00	3,834.76-	246,750.00
2	00104101	0	09	5.750	801	01		051502	.00	3,459.58-	246,750.00
2	00104101	0	09	5.750	801	01		081502	.00	.00	246,750.00
2	00104101	0	09	ESC/LC	835	01		081502	.00	10.00-	246,750.00
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2	00104101	0	09	5.750	802	01		111802	3,576.19-	.00	243,173.81
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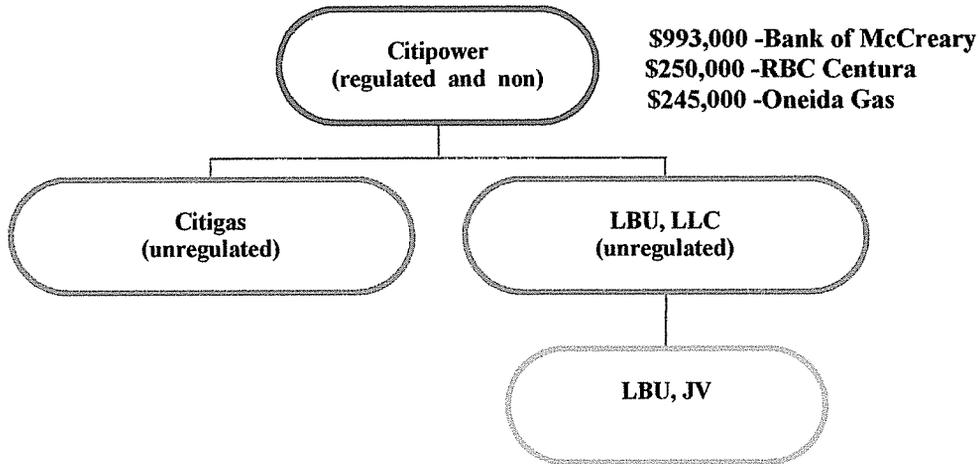
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EXHIBIT B

Proposed Reorganization Diagram

Citipower's Current Corporate Structure



Citipower's Proposed Corporate Structure

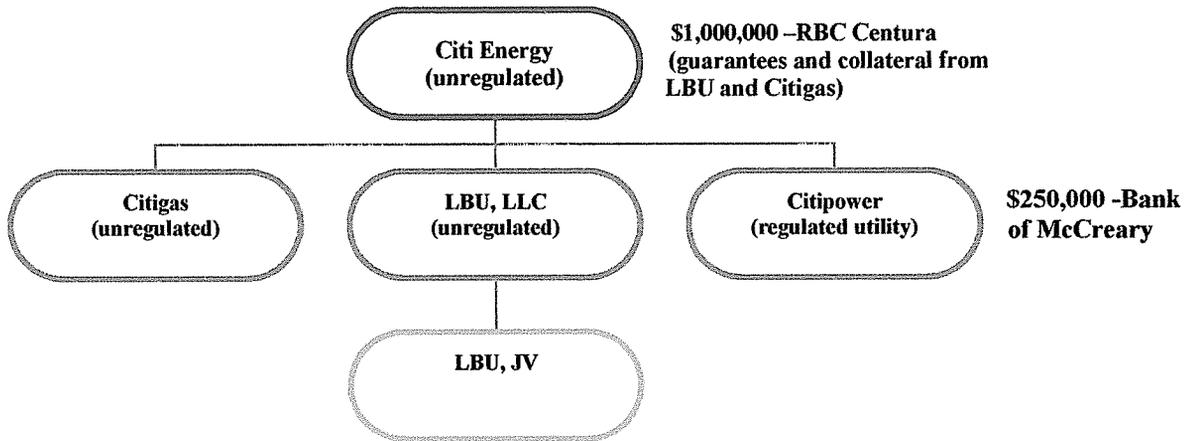


EXHIBIT C

Holding Company Pro Forma Financial Statements

**Citi Energy
Pro Forma Financial Statements**

Pro Forma 2004

Citi Energy Pro Forma 2004 Income Stmt.

	Income	Add Back Depreciation	Cash Flow
Equity in Earnings - Citipower	27,994.00	120,963.00	148,957.00
Equity in Earnings - Citigas	(97,492.00)	118,437.00	20,945.00
Equity in Earnings - LBU, LLC (estimated)	90,000.00	0.00	90,000.00
9 months - Jan. Thru Sept. 2004	<u>20,502.00</u>	<u>239,400.00</u>	<u>259,902.00</u>
<i>Annualized Estimated 2004 Total</i>	27,336.00	319,200.00	346,536.00

Citi Energy Pro Forma 2004 Balance Sheet

Investment in Citipower	2,895,292.00
Investment in Citigas	2,387,791.00
Investment in LBU, LLC	<u>2,300,637.00</u>
Assets Sept. 2004	7,583,720.00
Debt	1,488,174.00
Equity	<u>6,095,546.00</u>
Liab. & Equity Sept. 2004	7,583,720.00

Pro Forma 2005

Citi Energy Pro Forma 2005 Income Stmt.

	Income	Add Back Depreciation	Cash Flow
Equity in Earnings - Citipower	128,597.00	154,132.00	282,729.00
Equity in Earnings - Citigas	(148,501.00)	191,116.00	42,615.00
Equity in Earnings - LBU, LLC (est)	150,000.00	0.00	150,000.00
Pro Forma 2005 Projection	<u>130,096.00</u>	<u>345,248.00</u>	<u>475,344.00</u>

Citi Energy Pro Forma 2005 Balance Sheet

Investment in Citipower	3,023,889.00
Investment in Citigas	2,239,290.00
Investment in LBU, LLC	<u>2,450,637.00</u>
Pro Forma Assets December 2005	7,713,816.00
Debt	1,500,000.00
Equity	<u>6,213,816.00</u>
Pro Forma Liab. & Equity December 2004	7,713,816.00